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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

ROGER SCHLAFLY,

Plaintiff,

v.

PUBLIC KEY PARTNERS, a
partnership, and RSA DATA
SECURITY, INC., a California
corporation,

Defendants.

Case No. CV-94-20512-SW
(EAI)

RSA DATA SECURITY, INC.'S
AMENDED REPLY MEMORANDUM IN
SUPPORT OF SUMMARY JUDGMENT
ON PLAINTIFF'S ANTITRUST
CLAIMS

Date: August 27, 1997
Time: 10:00 a.m.
Courtroom: 4

The Honorable Spencer
Williams

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1 INTRODUCTION

2 Plaintiff's opposition to defendants PKP and RSA's motion for
3 summary judgment unmask this case for what it is and has always
4 been, an abstract crusade lacking any foundation in objective,
5 economic fact. It is fundamental to antitrust law that, absent
6 evidence of actual anticompetitive effect, a plaintiff must define
7 the relevant market and demonstrate defendants' economic power in
8 that market. Plaintiff has not even attempted to meet this
9 requirement.

10 Schlafly fails to adduce any evidence proving the relevant
11 market or defendants' market power. Since such proof is essential
12 to each of his Sherman Act claims, this failure of evidence,
13 alone, defeats his entire antitrust case. Schlafly also fails to
14 introduce sufficient evidence to demonstrate that defendants
15 actually engaged in any of the alleged improper conduct that might
16 give rise to an antitrust claim if he had met his burden of
17 establishing market power.

18 Schlafly's omission on the crucial issue of relevant market
19 is no mere oversight. To the contrary, his recent deposition
20 confirms that in the three years since this case was filed,
21 Schlafly has not developed a single "market fact" to support his
22 claims. He has developed no evidence showing that public key
23 cryptography was a defined market from 1990 forward and that
24 defendants had power in that market. In fact, the principal
25 encryption technology in 1990 at the time PKP was formed was
26 traditional symmetric key technology dominated by industry giants
27 such as IBM. Plaintiff's contention that defendants had "market
28 power" in that market is simply incredible.

1 At bottom plaintiff's grievance is that he was unable to
2 develop competing public key products because he could not obtain
3 the necessary licenses. He proffers no evidence of any harm to
4 consumers caused by defendants' alleged conduct not contemplated
5 by the patent laws. The Sherman Act, however, is designed "to
6 protect the public from the failure of the market," not to redress
7 the frustration of a thwarted would-be rival. Moreover, antitrust
8 law simply does not require patentees to license their patents to
9 any or all competitors on the terms they demand. Since Schlafly
10 fails to demonstrate that defendants did anything they were not
11 fully authorized to do by the patent laws, summary judgment for
12 defendants is warranted.

13 ARGUMENT

14 I. SCHLAFLY'S FAILURE TO INTRODUCE ANY EVIDENCE PROVING RELEVANT 15 MARKET AND MARKET POWER IS FATAL TO HIS ENTIRE ANTITRUST CASE.

16 Even though Schlafly has had three years to take discovery,
17 he fails to meet his burden of showing a relevant market and
18 defendants' power in that market. Each of his antitrust claims
19 therefore fails, warranting dismissal on summary judgment. *Rebel*
20 *Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1433-38
21 (9th Cir.), *cert. denied*, 116 S. Ct. 515 (1995) (section 2 claims)
22 (failure to demonstrate market power); *Thurman Industries, Inc. v.*
23 *Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1373-77 (9th Cir. 1989)
24 (section 1) (insufficient evidence of market power in relevant
25 market); *Morgan, Strand, Wheeler & Biggs v. Radiology, Ltd.*, 924
26 F.2d 1484, 1488-89 (9th Cir. 1991) (plaintiff's failure to
27 establish a relevant market defeats section 1 claim); *Flegel v.*
28 *Christian Hosp., Northeast Northwest*, 4 F.3d 682, 689-91 (8th Cir.

1 1993) (dismissing section 1 claim, finding no evidence to support
2 plaintiff's market definition, no evidence of market share);
3 *Levine v. Central Florida Medical Affiliates, Inc.*, 72 F.3d 1538,
4 1552-53, 1556 (11th Cir), *cert. denied*, 117 S. Ct. 75, (1996)
5 (dismissing section 1 and 2 claims, finding inadequate definition
6 of relevant market and no evidence of market power).

7 Because Schlafly has the burden of proof in defining the
8 market and in establishing market power, and because he has failed
9 to introduce any evidence on these issues, his claims must be
10 dismissed on summary judgment. *See Celotex Corp. v. Catrett*, 477
11 U.S. 317, 323 (1986).

12 **A. Market Analysis Is Essential To Each Of Schlafly's**
13 **Antitrust Claims.**

14 Schlafly states claims against defendants for attempted
15 monopolization under Section 2 of the Sherman Act such as tying
16 and patent misuse. He also alleges unreasonable restraints of
17 trade under Section 1 such as improper patent pooling and group
18 boycott. Market analysis, found nowhere in Schlafly's papers, is
19 essential to both sets of claims.

20 In the wake of the Supreme Court's decision in *Spectrum*
21 *Sports*, there can be no doubt that Schlafly's attempted
22 monopolization claims require proof of the relevant market and
23 market power. *Spectrum Sports Inc. v. McQuillan*, 506 U.S. 447,
24 456 (1993) (attempted monopolization requires inquiry into the
25 relevant product and geographic market and the defendants'
26 economic power in that market); *Rebel Oil*, 51 F.3d at 1433-34.¹

27 ¹ Attempted monopolization includes three elements: (1)
28 predatory or exclusionary conduct; (2) specific intent to

(footnote continued...)

1 Nor is there any dispute that Schlafly's Sherman Act § 1 claims
2 also require such a showing given that they all implicate the rule
3 of reason, not a per se analysis.² See *F.T.C. v. Indiana Fed'n of*
4 *Dentists*, 476 U.S. 447, 460 (1986) (in the absence of evidence of
5 restricted output or supra-competitive prices, plaintiff must show
6 that the defendant possessed market power in a relevant market).³

7 The first step in market analysis is defining the relevant
8 market. See *Rebel Oil*, 51 F.3d at 1434 ("without definition of
9 the relevant market, it is impossible to determine market power").
10 Market definition in turn has product and geographic dimensions.
11 A relevant product market consists of the "pool of goods or
12 services that qualify as economic substitutes because they enjoy
13 reasonable interchangeability of use and crosselasticity of
14 demand." *Thurman*, 875 F.2d at 1374; *Morgan*, 924 F.2d at 1489. A
15 geographic market encompasses the "area of effective competition
16 where buyers can turn for alternate sources of supply." *Morgan* at
17 1490; see *Bhan*, 929 F.2d at 1413.

18
19
20 (continued from previous page)

21 monopolize; and (3) a dangerous probability of success in
22 achieving monopoly power. *Spectrum Sports*, 506 U.S. at 456.

23 ² Courts evaluate the reasonableness of a restraint under the
24 per se rule or the rule of reason. Per se offenses consist of
25 naked restraints, such as price fixing or market allocation
26 agreements, which history and analysis show "always or almost
27 always tend to restrict competition and decrease output."

28 *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441
U.S. 1, 19-20 (1979); see *Bhan v. ATME Hospitals, Inc.*, 929 F. 2d
1404, 1410 (9th Cir. 1991), cert. denied, 502 U.S. 994 (1994).

³ Only if a plaintiff is able to show actual detrimental
effects or market power does the burden shift to the defendant to
demonstrate pro-competitive effects. The plaintiff may then show
that any such legitimate objectives can be achieved in a
substantially less restrictive manner. *Bhan*, 929 F.2d at 1413.

1 Once the market is defined, the next step is to determine the
2 defendants' share of that market. "Measurement of market share is
3 necessary to determine whether the defendant possesses sufficient
4 leverage to influence marketwide output." *Rebel Oil*, 51 F.3d at
5 1437.

6 **B. Schlafly Fails To Introduce Any Evidence Showing The**
7 **Relevant Product Or Geographic Market or Defendants'**
8 **Market Power.**

9 Schlafly does not clearly identify his definition of the
10 market, much less provide sufficient evidence to create a triable
11 issue. He suggests that the relevant product market consists of
12 "public key technologies in commercial use." His unsupported
13 assertion, however, does not carry his burden of introducing
14 evidence defining the market. In particular:

15 • He presents no proof whatsoever that public key encryption
16 technology constitutes a market distinct from encryption
17 technology in general, including traditional symmetric lay
18 technology.

19 • He provides no evidence that encryption products are not
20 part of a larger computer security market that includes PIN
21 numbers and password systems.

22 Schlafly's dearth of evidence on this dispositive issue is
23 far from accidental. As his July 25, 1997 deposition underscores,
24 this part of his case remains unresearched, and unprovable. For
25 example, Schlafly confirmed that, unlike his opposition papers,
26 his Amended Complaint alleges a "cryptography software market"
27 which includes "public key cryptography software." Depo. at
28

1 50:14-51:15.⁴ Even though market definition must be proven by
2 "market facts," Schlafly concedes that the only information he has
3 regarding these markets is based on his perusal of Internet and
4 press reports, none of which is competent evidence. *Id.* at 51:16-
5 52:3; 67:10-69:1.⁵ Even though he recognizes that market
6 definition is a subject for expert opinion, Schlafly has not
7 sought the views of an independent expert, *id.* at 52:4-53:16 and
8 vigorously sought to disqualify his own testimony regarding market
9 definition or market power. *id.* at 64:6-69:10 (objecting to
10 questions as calling for expert testimony).

11 **C. Schlafly Does Not And Cannot Show Market Power.**

12 Even if Schlafly did prove a relevant market, however,
13 defendants would still be entitled to summary judgment because he
14 adduces no evidence showing defendants' share of any alleged
15 market. *Levine*, 72 F.3d at 1553; *Flegel*, 4 F.3d at 691; *Morgan*,
16 924 F.2d at 1491. He ignores the fact that, as he later
17 acknowledges, companies other than RSA are licensed under the
18 Stanford and RSA patents to develop and market public key
19 products. Schlafly's charges of monopoly fail to account for
20 these licensees' respective shares of any purported public key or
21 cryptography software markets.

22 ⁴ Citations to the deposition of. plaintiff taken on July 25,
23 1997 are simply designated as "Depo."; the transcript is attached
24 as an exhibit to the Reply Declaration of Thomas Hogan submitted
with PKP's reply brief.

25 ⁵ Similarly, he confirms Bidzos' testimony that, in 1990, the
26 computer security market included "passwords, pin numbers as well
27 as encryption and other technology." While he denies that these
28 products were "substitutes," *id.* at 62:13-26; 108:21-109:13, when
pressed, he admitted that he has never posed this question to
customers or otherwise conducted any market studies. *id.*
109:14-110:5.

Schlafly's evidentiary failure on this front is again not mere oversight. At his recent deposition, Schlafly admits that the only data he has on this subject are "crude estimate[s]." *Id.* at 65:15-69:1. He further admits that "within encryption in 1990 the dominant technologies were the traditional symmetric key systems" (when measured in dollar volume), *id.* at 63:1-4, that he has no idea of what the dollar sales volume was for public key cryptography, *id.* at 65-66, and that his understanding of the size of the public key cryptography sales is only "a guess." *Id.* at 67; *id.* Depo. at 110-112 (admitting that he had no idea of RSA's unit sales volume on software tool revenue in 1990).

II. SCHLAFLY'S ANTITRUST CLAIMS ALSO FAIL BECAUSE HE CANNOT DEMONSTRATE THAT DEFENDANTS ENGAGED IN THE ALLEGED CONDUCT.

A. Schlafly Cannot Show Unlawful Patent Pooling.

Schlafly fails to introduce any evidence tending to support his allegation that PKP was an unlawful patent interchange. Contrary to Schlafly's suggestion, patent interchanges are not per se unlawful, but subject to the rule of reason. *Standard Oil Co. v. United States*, 283 U.S. 163, 171 (1931) (finding patent pool among competing oil companies lawful under the rule of reason); *Kaiser Industries Corp. v. Jones & Laughlin Steel Corp.*, 181 U.S.P.Q. 193, 223 (W.D. Pa. 1974), *rev'd on other grounds*, 515 F. 2d 964 (3d Cir.), *cert. denied*, 423 U.S. 876 (1975).⁶ Because

⁶ In fact, as Schlafly aptly notes, the Department Of Justice Intellectual Property Guidelines recognize that such arrangements can be entirely procompetitive:

These arrangements may provide procompetitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions and avoiding costly infringement litigation. By promoting the dissemination of

(footnote continued...)

1 Schlafly has failed to carry his burden of showing market power,
2 his pooling claim must be dismissed.

3 The only possible exception is when such arrangements serve
4 as an umbrella for naked price-fixing or market allocation
5 agreements. While Schlafly conclusorily asserts that RSA and
6 Cylink "divided the market" for public key cryptography, the
7 available facts do not support such a conclusion. Schlafly
8 adduces no evidence showing that, as part of the formation of PKP,
9 RSA or Cylink agreed to refrain from selling their respective
10 patented products to different sets of actual or potential
11 customers. Nor does the fact that RSA was in the software
12 business, while Cylink was in the hardware business, create any
13 such inference. The partners specialized in those respective
14 businesses before PKP and continued to do so during PKP; Schlafly
15 presents no evidence that the partnership caused them to change
16 their independent business strategies.

17 Schlafly further fails to demonstrate how PKP actually
18 restrained competition or afforded RSA any greater economic
19 rewards than its patents would individually justify. See *K.M.B.*
20 *Warehouse Distributors, Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 129-
21 30 (2d Cir. 1995) (showing of market power alone insufficient to
22 establish rule of reason violation); *Tunis Bros. Co. v. Ford Motor*
23 *Co.*, 952 F.2d 715, 727 (3d Cir. 1991) cert. denied, 505 U. S. 1221
24 (1992) (must show that defendant "exercised" market power).

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28 technology, cross-licensing and pooling arrangements are often
procompetitive. Guidelines, para. 5.5.

1 First, Schlafly falsely suggests that PKP increased industry
2 concentration by "pooling two horizontally competing
3 technologies." This view confuses PKP's exclusive sublicensing
4 rights to the PKP patents with a monopoly over a hypothetical
5 "public key" market, and is contrary to fact. PKP was not a
6 merger of RSA and Cylink. Nor did it eliminate competition
7 between Stanford and MIT-based technologies. RSA and Cylink
8 continued to compete after PKP just as before.

9 Second, Schlafly cannot demonstrate that PKP restrained any
10 competition in any patent rights market. To the contrary,
11 defendants' evidence shows that PKP was formed to promote the
12 dissemination of this fledgling, unproven technology by serving as
13 a "one-stop shopping center" for potential patent licensees thus
14 reducing transactions costs. Bidzos Decl. ¶¶6-7; Murray Decl.
15 ¶¶12-13.⁷ See *Intellectual Property Guidelines*, para. 5.5.
16 (reducing transactions cost procompetitive justification for
17 patent interchanges). As such, PKP existed to create -- not
18 eliminate -- new choices for consumers. While Schlafly believes
19 PKP should have granted more patent licenses at lower prices, he
20 still fails to explain why PKP would grant any patent licenses if
21 its true purpose were to eliminate competition in his proposed
22 market.

23
24 ⁷ Schlafly challenges the competence of the testimony of
25 William Murray by criticizing minor aspects of his declaration.
26 The Court need not even address this issue, however, to decide in
27 defendants' favor. It is Schlafly, not defendants, who carries
28 the burden of proof and his case fails, as a matter of law.
Moreover, the core point of Mr. Murray's declaration -- that
defendants have no market power -- stands completely unrebutted by
the plaintiff.

1 B. The Handguards Claim Must Be Summarily Dismissed.

2 Defendants can only be held liable for patent misuse under
3 Handguards if clear and convincing evidence shows that the patents
4 at issue were invalid or over-reaching, that defendants knew of
5 the defects in the patents, and that defendants had sufficient
6 market share to suggest a "dangerous probability of success." See
7 *Handguards, Inc. v. Ethicon, Inc.*, 743 F.2d 1282, 1288 (9th Cir.
8 1984) *cert. denied*, 469 U.S. 1190 (1985); *Argus Chemical Corp. v.*
9 *Fibre Glass-Evercoat Co.*, 645 F. Supp. 15, 17 (C.D. Cal. 1986),
10 *aff'd*, 812 F.2d 1381 (Fed. Cir. 1987) (elements of a Handguards
11 claim also include specific intent to monopolize a relevant market
12 and dangerous probability of success). Schlafly fails on all
13 three counts.

14 First (and dispositively), Schlafly does not even attempt to
15 establish a relevant market that defendants could have a dangerous
16 probability of success in monopolizing. Nor does he introduce any
17 evidence suggesting that defendants' market share was such that a
18 serious probability of monopolization existed. On that basis
19 alone, his claim must fail.

20 Second, none of the evidence cited by Schlafly shows that RSA
21 or PKP knew the Stanford patents were invalid or of exaggerated
22 scope.⁸ While the 1985 letter from patent counsel for Racal-Milgo
23 to Stanford, of which RSA received a copy in 1986, sets forth
24 various theories regarding the validity and/or scope of the

25
26 ⁸ Schlafly asserts that his *Handguards* claim also relates to
27 the MIT and Schnorr patents, but he adduces no admissible evidence
28 even remotely suggesting that RSA or PKP even doubted the validity
of these patents. Schlafly's unsupported convictions are not
RSA's or PKP's.

1 Diffie-Hellman and Hellman-Merkle patents, the subjective beliefs
2 of a third party's patent counsel are not probative of RSA's or
3 PKP's state of mind. See *Scripto-Tokai Corp. v. Gillette Co.*,
4 1994-2 Trade Cas. (CCH) ¶ 70,821, at 73,539-40 (C.D. Cal. 1994)
5 (knowledge of third party patent opinion concluding that patents
6 were invalid does not establish defendant's knowledge of such
7 invalidity). The fact that RSA cited the opinion as a defense to
8 willful infringement does not prove otherwise.

9 Nor does the fact that RSA learned, in 1992, about the
10 potential Diffie-Hellman preprint problem establish that RSA
11 actually knew the Diffie-Hellman patent was invalid. Third
12 parties informed RSA that it was their view that the invention was
13 disclosed in a printed publication. At best, this evidence
14 suggests that RSA had reason to question the Diffie-Hellman
15 patent. Reason to question, however, does not provide clear and
16 convincing evidence of actual knowledge of invalidity. *Scripto*
17 *Tokai*, 1994-2 Trade (CCH) Cas. at 73,539-40. This is particularly
18 true here given that the MIT/Stanford License Agreement gave RSA a
19 reason to believe -- not doubt -- Cylink's contentions Bidzos
20 Decl. ¶11.

21 Finally, Schlafly's patent misuse claim fails for the simple
22 reason that he is not asking this Court to rule that the Stanford
23 patents are invalid or broader than Cylink/CKC contended.
24 Schlafly gave up his efforts to obtain such a determination as
25 part of his settlement of his claims against Cylink/CKC. At his
26 deposition Schlafly admitted that as a result of that settlement
27 he is no longer seeking a determination from this Court in this
28 case that the Stanford patents are invalid or any narrower than

1 Cylink contends them to be. See Depo. at 102-104. Absent such a
2 determination that the Stanford patents are invalid and/or
3 narrower than Cylink has contended, it is impossible to understand
4 how defendants can be liable for patent misuse on these grounds.

5 **C. Plaintiff Cannot Establish That Defendants Engaged In**
6 **Unlawful Price Discrimination.**

7 Schlafly's description of the "anticompetitive effect" caused
8 by defendants' alleged discriminatory royalties highlights the
9 flawed assumption that underpins his entire antitrust case, that
10 the antitrust laws are designed to protect disadvantaged
11 competitors not consumers. According to Schlafly, RSA harms
12 competition by ostensibly not charging Netscape and Microsoft
13 royalties, which supposedly allows them to "giv[e] [software] away
14 over the Internet," to the detriment of competitors who are
15 saddled with per-unit royalties." Even if this story did not
16 consist of inadmissible hearsay, Schlafly's evidence would still
17 fall far short. All he shows is that some competitors have been
18 disadvantaged; consumers, in fact, benefit. See *Brook Group Ltd.*
19 *v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225
20 (1993) (below cost pricing not anticompetitive in itself because it
21 reduces aggregate industry prices for consumers).⁹

22 **D. Schlafly Has No Evidence Of Tying.**

23 As with his other claims, Schlafly's complete failure of
24 proof on the issue of market analysis dooms his tying claim, which
25 requires proof of sufficient economic power in the tying product

26 ⁹ Again, Schlafly's lack of evidence here is no oversight,
27 for at his deposition he admitted he does not know the price
28 Microsoft or Netscape were actually charged for their allegedly
favorable licensing terms. Depo. at 106-107.

1 to coerce unwarranted sales of the tied product. Jefferson Parrish
2 Hospital District No. 2 v. Hyde, 466 U.S. 2, 25-29 (1984). See
3 also 35 U.S.C. § 271(d)(5) (no liability under the patent laws for
4 tying absent proof of market power in the relevant market for the
5 patent or patented product on which the sale is conditioned). Nor
6 does Schlafly introduce any evidence of improper tying that might
7 give rise to a claim if he had carried his burden of defining the
8 relevant market.

9 The fact that RSA referred a potential licensee of the MIT
10 patent to PKP does not establish that RSA tied patent licenses to
11 software sales. On the contrary, it establishes a complete
12 absence of tying. It is undisputed that, after the formation of
13 PKP, RSA had no right to sublicense the MIT patent; only PKP had
14 such rights. Schlafly's suggestion that RSA tied sales of
15 software to patent licenses (or vice versa) confuses a patent
16 license (the right to develop an implementation of the MIT patent)
17 with a software license (the right to copy RSA code). During the
18 existence of PKP RSA sold software (copyright) licenses; it did
19 not grant patent licenses as that was the function of PKP. See
20 Schlafly Ex. GI (Jan. 10, 1996 Bidzos Decl. ¶ 19)

21 After PKP dissolved, RSA did start to license patent rights
22 again. When it did so, however, it took the clear position that
23 its software and patent licenses were separately available and
24 were not tied together. Thus, in the very letter Schlafly cites
25 regarding his own request for a license, RSA clearly stated that
26 either form of license (software or patent) was available. See
27 Schlafly Ex. GG (page 2, ¶ 11).

1 Not surprisingly, Schlafly admitted in his deposition that he
2 has never been told by anyone, or even read an account on the
3 Internet or in the trade press of anyone, who ever said that RSA
4 required them to purchase RSA software as the price of obtaining a
5 patent license. Depo. at 84-85, 87-88, 91. And for good reason:
6 it never happened.

7 **E. There Was No Boycott Or "Intimidation."**

8 Schlafly also fails to introduce any evidence showing that
9 RSA or PKP engaged in an unlawful boycott. The fact that PKP
10 lobbied ANSI and IEEE to adopt certain standards demonstrates the
11 forces of competition at work, not the opposite. Nothing in
12 antitrust law precludes a competitor from competing by promoting
13 its products.

14 **CONCLUSION**

15 Schlafly has completely failed to carry his burden of proof
16 on the most essential elements of his antitrust claims. Most
17 notably he has failed to put forward any evidence of defendants'
18 market power, relying on unsubstantiated assertions regarding a
19 "public key cryptography" market, a "market" he has completely
20 failed to define or distinguish from the market for cryptography
21 in general or other forms of computer security. Nor has he
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1 produced any evidence of any wrongdoing that might support an
2 antitrust claim if he had introduced evidence of market power.
3 Thus, for the reasons set forth above, Schlafly's antitrust claims
4 should be dismissed.¹⁰

5 Dated: August 14, 1997

HELLER EHRMAN WHITE & MCAULIFFE

6
7
8 By: Robert D. Fram (SEM)
9 ROBERT D. FRAM
10 Attorneys for
11 RSA DATA SECURITY, INC.
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26 ¹⁰ RSA hereby joins in the reply brief submitted by PKP and,
27 for the reasons set forth in that paper and in defendants' opening
28 brief, further requests that Schlafly's state law unfair
competition claims be summarily dismissed as well.